

# THE SCOTT LETTER: CLOSED-END FUND REPORT

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*A Global View of the Closed-End Fund Industry*

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THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site,

[www.CEFAdvisors.com](http://www.CEFAdvisors.com), and in particular, read our article, *What Are Closed-End Funds*. Feel free to forward this newsletter to anyone who you believe could benefit from information on closed-end funds or global portfolios.



– George Cole Scott  
Editor-in-Chief

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## The European Union Will Become the World's Largest Economic Area: Economic Growth Is Strong

Bulgaria and Romania joined the European Union ("EU") in January 2007. The 27-nation European Union has a population of nearly half a billion citizens and will become the world's largest economic area, providing new opportunities to all its citizens and businesses. This is the efforts of the Bulgarian and Romanian citizens, together with support from the EU. Economic growth in these countries has been strong, and unemployment has fallen sharply.

After 15 years of bold and significant reforms, the two new countries are in a posi-

tion to take on the rights and obligations of EU membership. Their accession is part of the historic enlargement of the European Union towards the East, finally overcoming the Cold War divisions in Europe and consolidating peace and stability.

The focus is now on building a new consensus on enlargement, which recognizes the strategic value of this policy while ensuring the Union's capacity to function. This process will continue with the countries of southeastern Europe (Turkey and Croatia) and other countries of the western Balkans. ■

## European Equity Fund and Central Europe and Russia Fund

The European Equity Fund (EEA-NYSE), formerly The Germany Fund, seeks long-term capital appreciation through investment primarily (normally at least 80% of assets) in equity and equity-linked securities of companies domiciled in countries utilizing the euro currency. Total net assets on March 31, 2007 were \$158 million. The portfolio held 61 stocks at that time. Portfolio turnover was 64%, and the expense ratio was 1.6%. The heaviest investments are in financial, industrial and healthcare stocks. The investment manager is Deutsche Investment Management Americas, based in New York.



Ralf Oberbannscheidt

The lead portfolio manager for EEA and The Central Europe and Russia Fund (CEE-NYSE) is Ralf Oberbannscheidt, a Director at Deutsche Asset Management. He joined the firm in 1999, earned his MBA from the University of Trier (in Germany) and also

holds a Masters Degree in International Finance from the Monterey Institute of International Studies.

Erin Doyle, assistant manager, has been a vice president of the firm since 2001. Ms.

Doyle holds a B.S. in Russian from Georgetown University and a Masters of International Affairs from Columbia University.

Closed-End Fund Advisors interviewed Mr. Oberbannscheidt on June 27, 2007.

### European Equity Fund

**SL:** Would you please describe your investment philosophy and style?

**Oberbannscheidt:** Both funds, EEA and CEE, focus on stock-picking. We consider the macro-economic trends in Eastern European and European regions. Investment alpha is primarily generated from focus on company strategy and competitive positions, a thematic

fit into global markets, management's track record and attractive valuation and/or superior growth profile compared to peer companies.

First, we have to understand management and strategy. Secondly, we look at the country level and how the macro-economic situation changes. Most companies in Europe are getting more global. In Germany, for instance, most of the blue-chip companies have as much as 60% of their business outside Europe.

**SL:** The objectives of EEA now include investing in companies in all European countries using the euro currency. How does this affect your investments in this fund?

**Oberbannscheidt:** We invest mainly in euro-utilizing countries, but we invest up to 20% outside of the portfolio's core universe. Examples of non-EMU countries where we invest are the U.K., Norway and Switzerland. The U.K. market, about 5% of the fund's assets, is a very attractively-valued, conservative market with good performance opportunities.

**SL:** Your latest report shows that The European Equity Fund has 77% of its investments in France, Germany, Italy and Austria, and include the United Kingdom, Greece and Ireland. Have any significant changes been made since year-end?

**Oberbannscheidt:** We are always re-evaluating our weightings and positions in these countries. We were overweighted in Germany at year-end as we were skeptical of the potential impact of the 3% increase in the value-added tax. Investors were afraid of this increase. Looking back six months, it didn't really have a significant impact on overall retail consumption. This shows the dynamic nature of Germany and the whole region. At the same time, the relatively high unemployment rate has decreased over the past year.

The biggest driver for reducing our weight in Germany was the valuation gap to the rest of the European markets. Germany no longer trades at a discount. We took profits to the benefit of France where we saw new investment opportunities. However, we have recently seen evidence that German consumer sentiment for investments and consumption is very

strong. Therefore, unemployment was reduced by 2.5%.

**SL:** Tell us about your investments in France, including energy companies.

**Oberbannscheidt:** France has created national champions in several industries. There is merger activity in the financials, pharmaceuticals and technology sectors, including a lot of synergetic potential. In the mid-cap area, there are interesting investment opportunities in sub-sectors such as global infrastructure. We have also invested in French energy and energy-related companies as well as in luxury goods. This is an investment theme for EEA.

**SL:** Are there many mergers taking place in Germany?

**Oberbannscheidt:** To my surprise, Germany has not seen that many mergers and acquisitions. There were more deals in France and the U.K. We wonder why, because in Germany corporate governance does not differ from other countries. Private equity companies could buy-out German blue-chip and mid-cap companies, providing an extra boost to performance.

Yes, there will be more acquisitions, but this isn't the basis for our investment process. Acquisitions are not one of our four investment themes. History has shown you cannot really buy stocks for takeover speculation and premiums. We would rather invest in solid companies with strong balance sheets and good growth stories. We are conservative, long-term investors, but we also monitor global equity market sentiment on a daily basis. Higher interest rates, inflation and political or regulatory changes in the countries where we invest are of specific interest.

**SL:** You buy growth stocks, but what about value investing?

**Oberbannscheidt:** It is always a trade-off. However, we are biased towards value and unjustified low valuations. The U.S. is more focused on the matrix for value growth, small-cap versus large-cap. We look for the best investment opportunities in our universe; growth expectations are underestimated for a lot of companies.

**SL:** According to our research, Europe's economy in 2007 is likely to match the fastest growth rates seen in this

Performance as of May 31, 2007			
European Equity Fund			
	1-Year	3-Year	5-Year
Market	31.47	28.22	13.90
NAV	29.13	25.11	14.57
Benchmark	37.26	27.15	16.92
Central Europe and Russia Fund			
	1-Year	3-Year	5-Year
Market	17.89	43.24	32.08
NAV	27.62	44.19	35.30
Benchmark	22.21	38.61	30.73

decade. Growth forecasts have been upgraded for 2007 and 2008. Comments?

**Oberbannscheidt:** Industrial production is a very volatile number, but it is solid. If you do a year-over-year comparison, the number might not provide an accurate picture. We expect an unwinding over the next couple of quarters. Retail consumption is picking up, a function of lower unemployment and psychology. The World Cup last year was a great event for business in Germany. People are now more optimistic about the future. There is also a generational shift as the younger generation is able to spend now and save later.

The German savings rate is 15%, one of the highest rates globally, so there is a lot of pent-up spending demand. My parents and grandparents, particularly after both World Wars, were very conservative. You first had to save, before you were allowed to spend. There has been a general change of sentiment in Germany.

Financial institutions promote a spending society by introducing consumer-friendly products that encourage spending, sometimes at the demise of savings. You now have a generational shift. People still tend to save before they spend versus other countries where people spend or accumulate debt before paying it back.

**SL:** Your latest reports show that your largest equity holdings in EEA were in banks and mortgage companies. Isn't that related to the issuance of credit cards by banks?

**Oberbannscheidt:** A little, but we see Europe as somewhat over-banked. The sector valuation looks interesting. Many of these banks are exposed to the rapid

growth of Eastern Europe. In addition, there have been bank mergers, especially in Italy, where much merger-and-acquisition activity takes place. We are overweighted in financials in EEA because of the restructuring of this industry.

The second biggest chunk of the portfolio is in the multi-billion dollar industrials sector. This supports our investment theme of global infrastructure spending.

**SL:** A recent report from the Organization for Economic Cooperation and Development (the Paris-based think-tank for 30 wealthy nations) shows globalization is “compatible with high interest rates, provided the right domestic policies are in place.” There is skepticism, however, between this view of globalization and the general public’s view regarding wages, unemployment and job insecurity. How do you answer these concerns?

**Oberbanscheidt:** There is skepticism about globalization, but Europeans have realized that the unemployment rate is going down, while at the same time there is more and more off-shoring to Eastern European countries. We have lived with this phenomenon for the last 10-20 years, so people are getting used to it. Recent wage negotiations between unions and different employers in various sectors are very positive, both for companies and for employees.

The trends appear to be in the right direction as more people are seeing the benefits of globalization. You will always have critics, but remember that Germany’s share of world exports is about 10%-12%. This has been linked to globalization over the last 30-40 years. You can’t really afford to be against globalization if your economy is dependent on exports.

**[Editor’s Note:** Globalization is our investment theme for 2007 and is something we firmly believe is needed to raise global living standards. However, many people do not understand the concept or its value to economies and stock markets. We will continue to pursue this important issue in future *Scott Letters*.]

**Oberbanscheidt:** Inflation is in check and balanced in Europe, about 1.8% on average – a level we can live with. The

global fear of inflation is monitored very closely; this is one of the macro-economic indicators that we watch.

Europeans have lived with higher taxes and gas prices, which are two or three times higher than in the U.S. The marginal impact of a gas price increase is, therefore, less shocking for Europeans than for Americans.

**SL:** What can you tell us about European monetary policies in relation to interest rates?

**Oberbanscheidt:** Expectations are that the ECB will increase interest rates by at least a quarter of a percentage point by year-end as Europe is growing faster than the U.S. this year.

The only tricky part for the ECB is that Europe is still a very diverse continent, not only culturally but also economically. With the introduction of the euro, you suddenly have to cope with different speeds of growth. Over the last decade, for instance, Spain grew faster than Germany, so higher interest rates would have made more sense for Spain but would have been a burden on the German economy. The EU has had to struggle to balance this going forward.

**SL:** How much attention do you pay to the level of U.S. interest rates in your strategies?

**Oberbanscheidt:** I look at currencies more than interest rates, although both are obviously linked. Higher interest rates imply further demand for the U.S. dollar. Recently, we have seen the opposite, as the euro strengthened in the belief that the economies of Europe are turning around and because interest rates are expected to further increase. We monitor this on a company-to-company level.

What is the exposure to exchange rates between the U.S. dollar, euro and yen? Companies become savvier as they learn from their mistakes. More and more financial instruments can be hedged, not only just for a few months but also for years. As part of our focused bottom-up investment approach, we talk to managements to understand where the risks lie within their businesses and divisions.

**SL:** As more and more countries are added to the euro zone, how quickly will you be able to invest in them?

**Oberbanscheidt:** EEA does invest in the new EU member countries, but as they are not yet members of the monetary union, these countries do not use the euro as a currency. We see valuations in Bulgaria and Romania already very high, even with their higher growth rates.

It has been five years since the announcement of their EU accession by the EEA. These markets need time to adjust their valuation to the Western European level. We invest in Western European companies with exposure to the Eastern European region, especially in the financial or utilities industries that have built production facilities and headquarters locally.

**SL:** Doesn’t it depend on a vote to expand the EMU?

**Oberbanscheidt:** Membership in the EMU depends on certain macro-economic data points that the countries who want to join the euro have to meet. This includes inflation targets and certain budgetary standards. Each country also has to demonstrate that it has been a member of the EU for a certain time period and is in line with the political union. If the macro-economic data is in check, there is no reason a new accession country could not join the euro. Some countries have political reasons for not wanting to give up their own currencies, such as the U.K. which wants to maintain its separation from the euro.

**SL:** What about the new EU Constitution?

**Oberbanscheidt:** I always treat business separately from politics. Business works much faster than politics as long as the EU is not adding more regulations. The smaller countries are benefiting more than bigger ones.

Are businesses impacted? Not initially, but the introduction of the euro was a big help, especially for mid-cap companies. Sometimes the EU regulations try to take over national regulations, such as the case in the telecom industry. I see more and more over-regulation on the EU level that is overriding business-friendly domestic regulation (in Germany). The regulator tries to disincentivise telecom network upgrades and the roll-outs in order to have more competition on the network.

However, if you are an incumbent operator like Deutsche Telecom and you want to roll-out a fiber network, you don't want to be forced to give access to your competitors. The EU thinks more about competition and lowering prices than creating incentives for a new technology upgrade. Businesses are efficient enough to adopt ways to go offshore if they don't like the regulations.



## Central Europe and Russia Fund

The Central European and Russian Fund (CEE:NYSE) with assets of approximately \$852 million seeks long-term capital appreciation through investment in equity and equity-linked securities of issuers domiciled in Central Europe and Russia. On March 31, 2007, the portfolio's concentration in Russia was 57%, followed by Poland (18%), Turkey (9%), Austria (5%), Hungary (5%), Czech Republic (4%) and smaller amounts in other countries.

On December 31, 2006, CEE had a net expense ratio of 1.04% and a portfolio turnover rate of 32%. CEE has a Dividend Reinvestment Plan and a voluntary Cash Purchase Program. In 2006, CEE paid a capital gains distribution of \$4.932 and an income distribution of \$0.584 per share. As of March 31, 2007, its portfolio was concentrated 35% in energy, 24% in financials and 13% in utilities.

Closed-End Fund Advisors continued its interview with Mr. Oberbannscheidt.

**SL:** How much time do you or your associates spend visiting companies in this region?

**Oberbannscheidt:** At least one person on our investment team will make an extensive research visit to the region every year. My associate, Erin Doyle, has just met with 20 companies in Ukraine. We also

tap our global research capabilities in Europe and the rest of the world. All our analysts are in contact with management teams, industry experts and outside consultants to digest the constant flow of new information.

**SL:** We are interested in the Central European area as well as Turkey, which also has had spectacular investment performance. However, as Russia is such a large component of the fund, we think it is most important to try to seek a deeper analysis in order to understand this complicated economy.

We are especially interested in the present status of economic conditions in Russia and how this affects the outside world's perception of Russia as a stable place in which to invest. Our preliminary research finds that Russia's exports are as much as 80% in oil, gas and timber. The energy exposure in the Fund is about 35% and is concentrated in five Russian oil companies. We are, therefore, concerned how this concentration appears to give your portfolio a higher market volatility than the other parts of the portfolio. Are you concerned about this as well?

**Oberbannscheidt:** Yes, we are, so recently we took some money out of Russia to the benefit of the Central European countries including Poland, the Czech Republic and Hungary.

Within Russia, we also shifted our sector focus because Russia has been viewed by investors primarily as a materials, oil and gas-rich nation. Our focus has shifted into areas that have benefited from the oil wealth, but Russia is no longer just an oil and materials proxy. More and more Russians are making money and have the money to go shopping.

In spite of this, the performance of the Russian market has not been satisfactory this year. The decline [of the shares] has been mostly in the oil and gas sector, while every other sector is higher. Since the market cap of the oil companies is so predominant, it looks like the whole Russian stock market is down.

**[Editor's Note:** The Russian stock market, as measured by the DJ Russian Titans 10 Index, was up 7.7% year-to-date (as of July 13, 2007) versus a rise of 14.4%

for the DJ World Index ex-U.S. for the same period.]

**SL:** In the last few months, the world oil markets have risen above the \$70 level. How has this factor affected the Russian economy?

**Oberbannscheidt:** Keep in mind that the energy companies have significant investment programs. You have to invest so you can keep oil production at the same level every year. This has had a negative impact on earnings over the last 6–12 months as the oil stocks are under pressure. We believe this will improve over the year, but you can't avoid the Russian oil and gas stocks, especially with oil prices above \$70 a barrel.

**SL:** There are many new gas pipelines being built and expanded for the European markets. We learned from the *Financial Times* that there is a new one now being built to transport the gas southward into Italy, for instance. Is this an important subject for discussion?

**Oberbannscheidt:** Yes, many Russian companies are trying to secure their gas supplies that are going to Europe. There are merger-and-acquisition discussions within the oil and gas company, Gazprom, which could buy distribution assets in Europe just to secure the markets there.

At the same time, many [European] countries are becoming more independent in their oil and gas supplies, especially Germany, which is now very dependent on Russian gas. There were incidents in the last 12–24 months where the Ukraine interrupted gas delivery to Europe, and Belarus didn't comply with price increases. That is why Europe is trying to get more independent by getting its supplies from the Middle East. Many companies are building liquefied natural gas ("LNG") facilities.

The oil and gas giants will add another \$30 billion to their economies. It is a global phenomenon. Governments all over the world inherently want to protect their natural resources. The overriding issues are the oil-and-gas joint ventures with Western companies.

**[Editor's Note:** Following these remarks, we have learned that Gazprom announced on July 13, 2007 that it has

chosen Total of France as a partner in developing its vast Shtokman gas field in the Barents Sea, off Russia's north coast. This ends months of indecision over foreign participation in these projects. Norsk Hydro, Statoil and Conoco Phillips are understood to still be in the running to join the new partnership.

There is also a new cooperation deal between Royal Dutch Shell PLC and state-owned Russian oil company, OAO Rosneft. This underscores how Russia is continuing to seek foreign partners in oil and gas projects. However, the American oil companies appear to be out of favor for this kind of deal, according to reports in London's *Financial Times*.]

**SL:** Isn't "going green" a big movement in Europe now? There is also a "Green Party" in Germany and other countries. What are your comments?

**Oberbannscheidt:** Yes, Germany is one of the success stories for this movement. Over the last year, Germany has been the world leader in solar technology and, to a lesser extent, in wind energy. It is really in engineering where the Germans will add value in the future.

**SL:** We were aware that Denmark was a leader in wind energy, but we didn't know Germany leads in solar technology.

My next question regards transparency and honesty of answers given to your analysts when they meet with representatives of Russian companies. There is a perception in the U.S. that there is a disconnect between what the company officials are saying and what is really happening. Is that a problem for your analysts?

**Oberbannscheidt:** It is the opposite. Transparency has improved over the last 5-7 years as companies are better in their reporting standards. The biggest concern for an investor is to know that the oil reserves are correctly audited and that the Russian companies are more open than previously to giving straight answers in discussing their investment strategies. There have been significant changes for the better, but there is, of course, room for improvement.

Russia still needs a lot of infrastructure investment and will, therefore, need the

capital of other countries to help them. At Gazprom, the largest energy holding of CEE, we ask about the reserves and discuss their influence because of their giant size. This company has a multi-billion dollar investment program every year, just to keep up with maintenance. They must reinvest the money they have coming in.

**SL:** Who conducts the audits of those companies?

**Oberbannscheidt:** The audits are conducted by independent global auditing firms, such as PriceWaterhouseCoopers, using global accounting standards. The investment banks oversee corporate actions. You always have risks, but these risks are now reduced as the Russian companies are more and more open to outside investors. In addition, some of the Russian companies are listing in the global equity markets, such as in London, which requires a more stringent and transparent listing criteria.

The focus of the fund is now more on infrastructure and utilities. In the utility sector, we see good restructuring potential. As much as \$60 billion will be required over the next 10 years in the utilities sector alone. Growth in banking, financials and especially retail are predominant themes. We see good growth in telecoms as well as in the retail sector.

**SL:** Tell us more about developments in the retail sector.

**Oberbannscheidt:** The top three retailers in Russia currently have about 5% market share. Incomes and retail sales have grown about 13% per annum, significantly higher than in Europe and the U.S. In the U.S., income growth per capita is only up 50% since 2001.

A lot of retail business is in farmers' markets and more recently in shopping malls. As the Russians make more money, they like to consume fancier foods and shop at nicer displays. We believe there is decent growth coming into Russia's retail system, not just in Moscow and St. Petersburg, but more so in the regions.

**SL:** We have recently learned that Moscow is now the most expensive city in the world in which to live, replacing London. This could hurt tourism, but we

are more interested in the current valuations of Russian stocks.

**Oberbannscheidt:** The price/earnings ratios of Russian shares are among the cheapest globally, ranking second right after Sri Lanka. They have an average price/earnings ratio of 10 times 2008 earnings for the whole market. The energy companies are even cheaper. Many emerging markets have performed so well recently that their shares trade at significantly higher P/E levels.

My data shows an average discount for Russian companies to the emerging markets of 25%. We don't believe in the terminology "emerging markets." Is Korea an emerging market with such global companies as Samsung? Gazprom isn't really an emerging market company either. In telecoms, why is a mobile company in Russia valued differently than in Germany? They all use the same equipment, and the regulations are more favorable in Russia where the growth is much higher than in Europe.

There is no reason for these companies to trade at a 25% discount. You have to look at it sector by sector, then company by company. Then you must find the peer group to justify the discount to their full value.

**SL:** What is the current Russian unemployment rate?

**Oberbannscheidt:** It is 6.9% – low not only because of the decreasing population but also because more and more personnel is needed for infrastructure roll-outs in sourcing the oil, gas and materials. They need to keep up with the growing demand.

The markets factor in some risk. It is partly corporate governance, but it is mostly the political risk that explains the discount. The coming Russian presidential election in March 2008 is also a factor in this discount.

**SL:** What can you tell us about Mr. Putin's successor?

**Oberbannscheidt:** I believe his successor will be someone who is "Putin-friendly." There will be no surprises. Mr. Putin may be back in the picture at a later time, so that creates some uncertainty. (He could run again in 2012.)

It's more of a conceptual question: Putin did a good job bringing Russia closer to the rest of the world. Keep in mind that Russia was a communist country, but economically and politically, I think Putin's successor has to look inside Russia. All the programs for housing, education and culture are part of the current shift within Russia. It is more than about oil and gas; it is about what is happening within.

**SL:** That is very interesting. We follow the action of CEE shares. Does shareholder perception of the oil and gas business explain the recent deep discount to net asset value on the stock, or are there other factors? CEE has a strong investment record since inception, so why do you think the shares trade at such a discount? (See performance chart on page 2.)

**Oberbannscheidt:** This appears to be because of outside sentiment towards Russia and skepticism about the election. It is also because CEE has its largest holdings in Russia. Historically, the discount has been at times even higher. We address this issue frequently. A favorable distribution

policy is in place. We can repurchase our shares, market the fund and talk to current and potential investors. The portfolios of the two funds are managed for their net asset value. If there is a discount, it is a good entry point for investors.

**SL:** We recognize that and have been taking advantage of the discount to purchase shares of CEE for our clients. (The discount for shares of CEE was -13.3% on July 13, 2007.)

This has been an extremely informative interview. Please now summarize your thoughts on the two funds.

**Oberbannscheidt:** Keep in mind that for EEA, the euro region is growing at different speeds. That is why we find different investment opportunities in all countries and sectors. The countries are still very different, but one of our bigger investment themes currently is global infrastructure spending. We also look at companies that have exposure to the emerging markets, where there is faster population and consumption growth. We look at the consumers and luxury goods

(brand names made in Europe). There is a potential for Europe to benefit from global growth because many countries export.

Regarding CEE, it is not all about oil, gas and materials, as there are a lot of well-managed companies in the different sectors. The fund invests in infrastructure-related sectors, such as utilities and telecoms, as well as in retailing where double-digit growth existed for over the last five years in a highly fragmented industry. There is also growth in mortgages and consumer loans.

We will monitor the upcoming elections very closely. Mr. Putin's acceptance rate is increasing, as Russians like what he has done as President. We will now have to fine-tune the scenarios for the different candidates. One candidate is looking into national projects such as healthcare, housing and culture. These are all aspects to be considered, and Russian companies will benefit.

For more information on EEA and CEE, call 1-800-349-4281 or visit [www.GermanyFund.com](http://www.GermanyFund.com) ■

## Hong Kong Marks Its 10th Anniversary

Celebrations, speeches and protests marked Hong Kong's 10th anniversary as a special region of China on July 1, 2007. We attended the 1997 event and witnessed its spectacular display of fireworks over the harbor. On July 4, we also met with Dr. Mark Mobius, the Franklin/Templeton emerging market guru who lives in Hong Kong. This was the same day the Thai currency crashed, precipitating the Asian financial crisis and spooking investors around the world.

We found that there was much skepticism that the new arrangement would work, but Hong Kong has shown that it is an economic miracle. The dynamic city of seven million people welcomed a visit from Chinese President Hu Jintao, his first visit since his predecessor oversaw the hand-over to China.

There are still concerns over poor air quality, a growing wealth gap and the pace of democratic change as Hong Kong

continues to enjoy a separate political and legal system. The city has wrestled with the question of how quickly to introduce direct elections. The chief executive is currently chosen by an 800-member body that largely reflects business and pre-Beijing interests.

Mr. Hu praised Hong Kong as a city "that is thriving as never before." He also reaffirmed the Chinese government's commitment to Hong Kong's political autonomy but warned that the city should focus its attention on economic development while "maintaining stability and developing a democratic system that suits its actual conditions." Hong Kong must resolve these issues through "cool headed dialogue."

Protestors from a variety of causes – from heritage preservation, wage legislation to the release of imprisoned journalists in mainland China – staged orderly marches.

"When they give us direct elections, I will stop marching," one protestor said.

We also found some concern over Hong Kong's continuation as China's principal port and financial center. Ambitious cities like Shanghai threaten to displace it.

"Hong Kong is not the biggest city in China, but it can be the best," its chief executive, Donald Tsang, said after being sworn in by President Hu for his final term ending in 2012.

When I interview Dr. Mobius annually for this newsletter, I often ask him about the concerns regarding Shanghai, which I have also visited. He always says that it has not been a problem, stressing that the accessibility of Hong Kong's location as a strategic harbor is a big plus in its competition with Shanghai. The Hong Kong Stock Exchange also has higher investment standards than those of Shanghai. China has three stock exchanges: Hong Kong, nearby Shenzhen and Shanghai.

Hong Kong maintains a highly capitalistic economy based on a policy of free market, low taxation and government non-intervention. It has the greatest concentration of corporate headquarters in the Asian Pacific region, and it is an important center in the People's Republic of China in terms of gross domestic product per capita. A penthouse recently sold there for \$23.65 million. Its gross domestic product per capital exceeds the four big economies in Western Europe (U.K., France, Germany and Italy) as well as Japan.

Hong Kong has been cited as a prime example of laissez-faire capitalism and was ranked as the world's freest economy for 13 consecutive years.

Closed-End Fund Advisors' largest holding, the Asia Pacific Fund, is managed in Hong Kong. We interview the portfolio manager of this fund each year. The last *Scott Letter* interview was published in March 2007 and is available from our web site ([www.cefadvisors.com/ScottLetter/2007/2007.php](http://www.cefadvisors.com/ScottLetter/2007/2007.php)). ■

Source: *The Wall Street Journal*, Wikipedia.org

## Closed-End Fund Forum on September 26

The Closed-End Fund Association will conduct the 2007 New York/New Jersey Closed-End Fund Forum on September 26, 2007 at the Hyatt Regency, Two Exchange Place, Jersey City, New Jersey. This exciting event will provide opportunity to learn more about the latest

investment outlook in closed-end funds, review product trends, hear about current product innovations and meet leading equity, fixed income and global closed-end portfolio managers. Visit their web site ([www.closed-endfunds.com](http://www.closed-endfunds.com)) for more information or to register on-line. ■

## Portfolio Manager's Review

During June, our major activity was in the Swiss Helvetia Fund (SWZ: NYSE) rights offering which was priced at \$16.60 per share, well below its average price for the last 12 months. This provided an opportunity for our clients to increase their holdings in SWZ and for those who didn't already own shares to buy it at bargain prices. SWZ closed at \$18.79 per share on July 13, 2007.

We also purchased additional shares of Central Europe and Russia Fund (CEE: NYSE) as it appeared to be a good hedge against higher oil prices. This turned out to be the case, but the above interview showed CEE is much more than an oil fund, as prosperity from the energy sector is spreading throughout Russia.

We also purchased additional shares of Adams Express, a core holding and a good performer in both up and down markets. We added to ING Clarion Global Real Estate Fund (IGR:NYSE) which has been

trading at a deep discount. Global real estate funds have been performing better than many U.S. real estate funds.

To fund new purchases, we are selling shares of Alpine International Real Estate Fund (a mutual fund) as well as our other real estate closed-end funds in this sector to reduce our real estate exposure. We also think that the weakness in the real estate sector has gone its course. We will have a report on this in the August edition of *The Scott Letter*. Our semi-annual rebalancing will continue into July as we work our portfolios to bring them in-line.

In the Hybrid Income Portfolio, we added funds that are better able to withstand interest rate fluctuations, such as floating rate funds. We have used The Templeton Emerging Markets Income Fund (TEI:NYSE) to hedge against the continuing decline of the U.S. dollar. ■

*George Cole Scott*

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